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IN THE

Supreme Court of the United States

OCTOBER TERM, 1967

No. 348

BENEFICIAL FINANCE COMPANY, INC.,
Petitioner,

v.

LEO VINE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner, Beneficial Finance Co., prays that a writ of certiorari issue to review a judgment of the United States Court of Appeals for the Second Circuit, which reversed a judgment of the United States District Court for the Southern District of New York dismissing the amended complaint herein.

Opinions Below

The opinion of the United States Court of Appeals for the Second Circuit, appended hereto as Appendix A, is reported in 374 F. 2d 627.

Prior opinions of the United States District Court for the Southern District of New York in earlier stages of this litigation are reported in 252 F. Supp. 212 and [1964-1966 Transfer Binder] CCH Fed. Sec. L. Rep. ¶91,663 and appear in the record (R. 24a, 26a).

Jurisdiction

The judgment of the Court of Appeals was entered on March 13, 1967. A timely petition for rehearing filed on March 28, 1967 was denied on April 11, 1967 (R. 26b, 41b). The jurisdiction of this Court is invoked under 28 U. S. C. § 1254(1).

Questions Presented

1) Whether an involuntary conversion of the respondent's stock into a claim for cash (resulting from a short form merger without any action by respondent) is a sale under Section 10(b) and Rule 10b-5 and within the definition of sale in Section 3(a)(14) of the Securities Exchange Act of 1934, notwithstanding that the definition specifies contractual volition.

2) Whether the deception element of Section 10(b) and Rule 10b-5 necessary to support the complaint of respondent may be found in alleged deceptive securities transactions by the petitioner with persons other than respondent, petitioner having had no securities transaction with the respondent.

Statute Involved

Section 10(b) relating to deception in connection with the sale or purchase of securities, together with the definition of a sale of securities contained in Section 3(a)(14), of the Securities Exchange Act of 1934, 15 U. S. C. § 78 j (b), § 78 c (a)(14), 48 Stat. 891, is appended hereto as Appendix B. Rule 10b-5 of the Securities and Exchange Commission, 17CFR 240.10b-5, promulgated under Section 10(b) is also included in Appendix B.

Statement

The cause of action alleged in the amended complaint (R. 12a) consists primarily of a claim under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5. There is also alleged a common law cause of action (not separately stated) sought to be brought in the Federal Court on the basis of diversity of citizenship. The Court of Appeals decision rested on the applicability of Section 10(b) and Rule 10b-5, and the common law cause of action was regarded by that Court merely as a pendent claim.

Rule 10b-5 forbids fraud "in connection with the purchase or sale of any security". Section 3(a)(14) states "the terms 'sale' and 'sell' each include any contract to sell or otherwise dispose of."

The respondent is the holder of 100 shares (out of 624,870 shares) of Class A stock of Crown Finance Company Inc., a Delaware corporation (Crown), which he bought for less than $100 in 1962 (R. 13a, 14a, 29b).

Commencing in 1963 petitioner, Beneficial, purchased over 95% of the Class A common shares and all of the Class B common shares of Crown from stockholders of Crown, other than respondent (R. 28a).

Respondent has never, in fact, sold his stock to petitioner. What occurred was that Crown was merged into a subsidiary of petitioner by means of a so-called "short form" merger, which was effected under the applicable state statutes by a subsidiary of petitioner owning over 95% of the Crown stock. No action by respondent was necessary or was sought in connection with such short form merger. Respondent's stock was thereby simply converted without action by him into a claim for cash in the amount of $329 (or a different sum as might be determined at respondent's election in an appraisal proceeding). (R. 13a, 20-21a)

The District Court held that in these circumstances there was no sale and no fraud on respondent within the purview of Rule 10b-5 (R. 26a).

The Court of Appeals held that the short form merger was a "sale" by respondent. Although respondent did no voluntary act and was in no way deceived, that Court held that respondent's allegation that other stockholders of Crown were deceived into selling their stock to petitioner constituted fraud "in connection with" the non-existent "sale" by respondent to petitioner.

The amended complaint revolves around the fact that petitioner paid substantially more, per share, for the Class B common stock (which carried the right to elect two-thirds of Crown's Board of Directors) than it paid for such shares of Class A stock as it purchased. Respondent charges that these purchases by petitioner from others were fraudulent on the ground that, *if* petitioner had purchased all the *assets* of Crown and *if* Crown had been *dissolved* and *liquidated,* each share of Class A stock would have received more, and each share of Class B common stock would have received less, than the purchase price paid by petitioner for the shares. However, this allegation of fraud on others does not confer Section 10(b) or Rule 10b-5 jurisdiction over respondent's claim. He did not sell and he was in no way deceived.

Reasons for Granting the Writ

The Court of Appeals has decided an important question of Federal law, which has not been but should be settled by this Court, and has thereby erroneously extended Federal jurisdiction under the Securities Exchange Act of 1934 beyond the plain intent and meaning of the statute.

The decision, if allowed to stand, will greatly increase litigation in the Federal Courts relating to questions of alleged general corporate mismanagement or wrongdoing heretofore handled in the state courts.

The decision would also greatly expand the scope of trial and pre-trial procedure through which plaintiffs in such cases would try to prove the deception of a multitude of other security holders which enabled defendants in those cases to obtain sufficient stock to give them the power to affect the plaintiffs' securities. This was the alleged causal connection relied on in the Court of Appeals decision to bring this case within the ambit of Section 10(b) and Rule 10b-5 (A-13).

The decision of the Court of Appeals is believed to be clearly erroneous. It is essential for Federal jurisdiction under Section 10(b) that there shall have been (a) a sale which would necessarily involve a voluntary act by the respondent as indicated by the definition in Section 3(a)(14) and (b) deception of the respondent in connection therewith. The opinions of the District Court applied these principles.

Notwithstanding these principles, the Court of Appeals held that an involuntary conversion (resulting from a short form merger in which respondent took no action) of the respondent's stock into a claim for cash was a "sale", and that respondent may maintain a cause of action although he clearly had no transaction with petitioner and was not deceived, on the theory that alleged deception of others was fraud "in connection with" a "sale" of stock by respondent.

Under the laws of Delaware and New York, the short form merger was effected by petitioner's subsidiary solely by the action of its own Board of Directors, because it owned over 95% of the Crown stock. In connection with

such short form merger, no representation was made to respondent and no action was asked or required of him or taken by him. In these circumstances, there was in fact no transaction by respondent "in connection with" which fraud could have been practiced on him.

The situation is analogous to a redemption of stock by a corporation, which has been held not to be a sale by the stockholder within the ambit of Section 10(b), *Mills* v. *Sarjem Corp.*, 133 F. Supp. 753, 763 (D. N. J. 1955). Thus the "sale" element as well as the "deception" element of applicability of Section 10(b) are missing.

In ruling that there was a sale within Section 10(b) and Rule 10b-5, the Court of Appeals seems to rely on the fact that the definition of "sale" in Section 3(a)(14) of the Act states that "sale" shall "include any contract to sell or otherwise dispose of" (A-11). But we point out that this does not purport to make every disposition, involuntary or voluntary, of a security a "sale",—only *contracts to sell or otherwise dispose of* were brought within the definition of "sale", which points up the need for volition. There admittedly was no such sale contract with, or voluntary act by, respondent in the present case.

We submit that the Court of Appeals also was wrong in holding that the alleged deception of other stockholders of Crown who sold shares to the petitioner was a deception "in connection with" a sale by respondent to petitioner.

Can such fraud in connection with a stock acquisition with others be stretched to bring under Section 10(b) and Rule 10b-5 jurisdiction the claim of a person who sold no stock merely because he claims that the fraudulently purchased stock was later used to his disadvantage? Heretofore the courts have been unwilling to find a causal connection in such a situation for the purpose of Rule 10b-5, *Hoover* v. *Allen*, 241 F. Supp. 213, 229 (S. D. N. Y. 1965).

Suppose Crown had remained a Delaware subsidiary of petitioner and the New York subsidiary of petitioner owning over 95% of the stock had not effected a short form merger with Crown. There could then have been no claim by respondent under Section 10(b). Why should there be a different result because the petitioner's New York subsidiary exercised its statutory right to have a short form merger?

Apart from the District Court decision in *Voege* v. *American Sumatra Tobacco Corp.*, 241 F. Supp. 369 (D. Del. 1965), the reasoning of which opinion the Court of Appeals expressly does not accept, the decision of the Court of Appeals is without precedent. In fact the court in the *Voege* case did not attempt to hold that a suit may be brought under Section 10(b) by a person who is not himself a deceived seller or purchaser. Further, it appears that the Court of Appeals decision is inconsistent with leading cases in its own and other Circuits.*

In *Birnbaum* v. *Newport Steel Corp.*, 193 F. 2d 461 (2d Cir. 1952), *cert. denied*, 343 U. S. 956 (1952), the court ruled (p. 464) that Section 10(b) was not intended to be a general regulatory provision and was to be applied only where the appellant was himself a defrauded purchaser or seller, saying that the Section:

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* The situation here is distinguishable from that in *Dasho* v. *The Susquehanna Corp.*, No. 15839 (7th Cir., June 26, 1967). There, the issue was whether the exchange of stock in a company being merged into another company for the stock of the latter was a "sale" of the stock of the surviving company. The Court of Appeals for the 7th Circuit held that it was and that the surviving company had a cause of action under Section 10(b) against its own directors for fraud in connection with its issuance of securities. The case involved a conventional merger, not as here a short form merger which included no issuance of stock by the surviving corporation and no deception of the plaintiff.

> "* * * was directed solely at that type of misrepresentation or fraudulent practice usually associated with the sale or purchase of securities rather than at fraudulent mismanagement of corporate affairs, and that Rule X-10B-5 extended protection *only to the defrauded purchaser or seller.*" (Emphasis added.)

Professor Loss in his treatise on securities regulation notes that the Court's view in *Birnbaum* "seems basically correct" and that "its version of the 'legislative history' of the rule is accurate." 3 Loss, Securities Regulation 1469 (2d ed. 1961).*

The ruling by the Court of Appeals that a sale covered by Rule 10b-5 may take place without any voluntary action by the stockholder and that the required fraud ingredient may be found in alleged fraud in connection with security transactions by the defendant with others than the complaining stockholder seems to us clearly inconsistent with the basic purpose of Section 10(b) and of Rule 10b-5 as set forth in the *Birnbaum* case. The allegations here of injury to respondent cannot possibly be regarded as being based on the type of misrepresentation or fraudulent practice usually associated with the sale or purchase of securities.

The ruling below appears to us also to be inconsistent with *O'Neill* v. *Maytag*, 339 F. 2d 764 (2d Cir. 1964) which reiterates the purpose of Section 10(b) as enunciated in the

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* As counsel for the Securities and Exchange Commission, Mr. Loss had previously filed a brief to the effect that a conventional consolidation did not constitute a "sale" of securities under the Securities Exchange Act, even though a vote of stockholders was there required. The brief was quoted with approval by the Ninth Circuit Court of Appeals. *National Supply Co.* v. *Leland Stanford Jr. University*, 134 F. 2d 689, 694 (9th Cir. 1943), *cert. denied*, 320 U. S. 773 (1943). In the present case counsel for the SEC filed a brief amicus curiae taking the side of the respondent, but the Commission did not furnish any expertise as to the construction of the statute and there has been no ruling or interpretative action on the point by the SEC.

Birnbaum case, *supra*, and which further holds that, in order for a Rule 10b-5 cause of action to exist, the suing seller or purchaser must himself have been deceived in connection with a security transaction. The rule is the same in the Third Circuit, *Kremer* v. *Selheimer*, 215 F. Supp. 549, 552 (E. D. Pa. 1963).

If the Court of Appeals decision stands, there must logically be a trial as to whether more than 2,000 stockholders of Crown who sold their stock to petitioner were deceived in connection with their sales. This is because the Court of Appeals decision held that the deceit on which the complaint rests was deceit of Class A stockholders who sold enough stock to petitioner to enable it to put through the short form merger. Thus respondent must prove that deceit was practiced on enough selling stockholders to give petitioner the required 95%. What a Pandora's box would be opened up for the District Court to deal with!

It seems to us that the outcome of this petition is of great importance in that the decision of the Court of Appeals would open up a tremendous additional area of Federal jurisdiction under Section 10(b) and Rule 10b-5 not intended by Congress.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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